Testimony of

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For the

STATE OF NEW YORK

on behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

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FINANCIAL SERVICES SUBCOMMITTEE ON

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UNITED STATES HOUSE OF REPRESENTATIVES

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Good morning Chairman Bachus, Congresswoman Waters and members of the Subcommittee. I am Elizabeth McCaul, Superintendent of Banks for the State of New York, and Chairman of the Conference of State Bank Supervisors (CSBS). Thank you for asking us to be here today to share the views of CSBS on regulatory burden reduction and the "Financial Services Regulatory Relief Act of 2002."

CSBS is the professional association of state officials who charter, regulate and supervise the nation's over 6,000 state-chartered commercial and savings banks, and more than 400 state-licensed foreign banking offices nationwide.

We applaud your commitment and efforts to reduce the burdens imposed by unnecessary or duplicative regulations that do not advance the safety and soundness of our nation's financial institutions. This committee deserves special recognition for its efforts to remove these federal regulatory burdens, allowing our banks to compete with other financial entities at home and around the world. This competition encourages efficiency and innovation, benefiting the economy and consumers alike.

However, the most important contribution toward reducing regulatory burden reduction may be empowering the state banking system. The vast majority of innovations in banking products, services and business structures are the product of state banks and the flexibility of the state chartering system. CSBS

greatly appreciates the commitment of the Congress to preserve and enhance the ability of the states to respond to customer and business needs. Support of dual federal and state chartering will allow our financial markets to continue to be the world's most vigorous.

Choice in the regulatory environment can have many of the same benefits that it has in the business environment. Knowing that banks have a choice, regulators work smarter and more effectively. The safety and soundness of the financial institutions we regulate is our goal, and it is essential that we have the necessary resources to ensure a healthy banking system. Without the existence of a parallel regulatory system, however, an expensive, inefficient and monolithic regulatory regime could easily develop that would burden and restrict financial institutions, disadvantage them in the marketplace, and create a less healthy banking system. As our founding fathers recognized, we need federalism, not just federal, in our banking system.

Through innovation, coordination, and the dynamic use of technology, states have made great strides in reducing regulatory burden for the institutions we supervise. As Congress considers new regulatory burden relief measures, we ask you to ensure that we can continue to pursue these efforts. We also ask you to consider initiatives that will provide equal competitive opportunities for state-regulated and federally-chartered institutions, and that will clarify the interaction of state and federal law and the ability of state governments to protect its citizens.

Innovating to Reduce Regulatory Burden

The state banking departments have always sought to measure each regulatory requirement against its benefit to the public. In supervising state-chartered institutions, we have seen how the cumulative burden of regulatory requirements can have a detrimental effect on the public by diverting banks' resources from lending and other financial services to regulatory compliance.

Over the past few years the states, independently and in conjunction with our federal counterparts, have focused their efforts on reducing the burdens on state-chartered institutions. They have done this by streamlining regulatory procedures, rescinding unnecessary regulations, embracing technology to improve the examination process, and working together to assure the strength and survival of the state banking system.

Let me briefly mention a few examples.

Last year, the Hawaii legislature passed a law that lets banks enter the state by opening a new bank or branch even if the bank's home state does not allow *de novo* entry. Hawaii is not alone in its efforts to facilitate interstate branching. In fact, 24 states have enacted or updated streamlined interstate branching laws within the past four years.

Kansas amended its banking statutes last year to allow expedited branching and relocation procedures for well-capitalized and well-managed banks. By removing ATM and loan production office application requirements as well, Kansas now allows its banks to establish these as they wish.

Pennsylvania removed some of its restrictions on the ability of out-of-state trust companies to branch into Pennsylvania, thus expanding business opportunities for all state-chartered trust institutions.

Last year, Connecticut eased its requirements for holding companies seeking to establish or maintain an office of a subsidiary in the state. Georgia also reduced both the paperwork requirements for bank holding companies and the filing procedures for banks seeking to conduct an expanded range of financial activities.

Montana no longer requires banks to submit an application to close a branch. Instead, banks file a less burdensome notice statement.

A majority of the states, including my own state, New York, must review their statutes annually to modernize and streamline their regulatory procedures. When the Gramm-Leach-Bliley Financial Services Modernization Act became law in November 1999, many states used the occasion to conduct a wholesale review

of regulations and modernize their banking laws. The result is that more than half of all the states have recodified their banking statutes since 1995.

I do not mean to suggest, by the examples I have just cited, that these provisions will or should be enacted in all fifty states. One of the chief virtues of the dual banking system is that it permits innovation and experimentation at a more local level. That way, new ideas can be tested and refined in one or several states before they are adopted nationwide.

Many other states have focused their attentions on making bank regulation more efficient, and have implemented a "best practices" strategy toward regulation. And, of course, all of the states have worked hard to keep examination fees and supervisory assessments low for their banks.

Coordinating to Reduce Regulatory Burden in an Interstate Environment

Coordination and cooperation have been hallmarks of state bank supervision since the early 1990s. CSBS strongly believes that a system of multiple regulators can actually reduce regulatory burden by avoiding a financial regulatory oligarchy. To accomplish this, however, coordination and cooperation is necessary among all regulators involved in supervising an institution.

The state banking departments have done much to reduce regulatory burden

not just individually, but as a system. With Riegle-Neal's enactment in 1994, CSBS formed, with the FDIC and the Federal Reserve System, the State-Federal Working Group. The working group's goal is to minimize conflicts and duplication among the state and federal bank regulators in supervising interstate state-chartered banks.

Separately and through the State-Federal Working Group, the state banking departments developed two agreements: the Nationwide Cooperative Agreement, signed by all 54 state banking departments, and the Nationwide State/Federal Supervisory Agreement, signed by the states, the FDIC and the Federal Reserve. Signed in November 1996, the Nationwide Agreements – unanimously agreed to by the state banking departments, the Federal Reserve and the FDIC – were the culmination of two years of work toward a system of "seamless supervision" for the interstate operations of state-chartered banks. The agreements serve as a model for cooperation and coordination between the states and the federal regulators.

The agreements provide a single regulatory point of contact for state-chartered banks that branch across state lines. Federal and state regulators have each designated a single point of contact for the overall supervision of a multi-state bank. Most recently, the Working Group produced a single uniform

application for interstate branching. To date, over two-thirds of the states have adopted this form, and more are considering its adoption.

The states have also been helpful in contributing to the federal agencies' own coordination efforts as well. When the Office of the Comptroller of the Currency, the Office of Thrift Supervision and the Federal Deposit Insurance Corporation jointly developed a uniform charter and deposit insurance application, CSBS worked with these agencies to ensure that the forms would also meet the needs of state chartering authorities.

These coordination efforts benefit all financial institutions operating in the United States, not just domestic banks. Through a CSBS-led effort, state and federal bank regulators signed agreements in 1998 to create a streamlined system for the supervision of U.S. offices of foreign banks across state lines. These agreements, signed by the states, the Federal Reserve and the FDIC, are modeled after the domestic agreements for interstate supervision.

These Agreements seek to improve coordination and cooperation in the supervision of the multi-state operations of foreign banking organizations that operate under a state license or charter. They provide for a seamless supervisory process with minimal regulatory burden, and ensure that supervision is flexible and commensurate with the bank's structure and risk profile.

Looking beyond depository institutions, we realize that providing trust services has increasingly become an interstate business. The states have adapted by developing a model form states can use for processing requests for state-chartered institutions to operate on a multistate basis.

At the state level, to further this necessary cooperation and coordination, we have formed joint task forces with the National Association of Insurance Commissioners (NAIC), the North American Securities Administrators Association (NASAA), and the National Association of State Credit Union Supervisors (NASCUS). The purpose of these task forces is to share information and, where appropriate, to coordinate supervision toward our mutual goal: a wide range of safe, responsible, accessible financial services for our states' citizens.

To facilitate this coordination, regulators representing the Conference of State Bank Supervisors (CSBS) and the National Association of Insurance Commissioners (NAIC) jointly developed a model agreement to improve the coordinated supervision and regulation of banks engaged in insurance sales.

This effort has helped supervisors avoid imposing regulatory burdens, such as making redundant requests for information or failing to coordinate responses to consumer complaints. Coordination in these areas should benefit banks engaged

in insurance sales and lead to more efficient, streamlined supervision.

Efforts such as these recognize that while the differences in law allowed by our dual banking system often produce innovation, some differences can inhibit the competitiveness of our financial institutions. We are committed, as a state system, to fostering diversity while working toward certain consistent goals. We recognize that we must encourage a broad range of opportunity, while giving financial institutions a degree of certainty and consistency so that they can serve their customers effectively across state lines. This is the true value of the state charter – it is a charter of choices.

Role of Technology

Technology has played, and will continue to play, a large part in state regulatory relief efforts. Through the use of shared technology, state and federal banking agencies work together continuously to improve the quality of the examination process, while making the examination process less intrusive for financial institutions.

Through CSBS, the state banking departments have played a pivotal role in coordinating efforts with the federal regulators to develop and improve several automated examination tools that will strengthen the examination process and facilitate more efficient, risk-focused, quality examinations. Our goals are to

make the time examiners spend in the institution more productive, and to expedite the entire examination process, thus freeing bank management to devote their efforts to the business of banking.

Individual states have also been able to streamline their regulatory procedures through technological enhancements. Several states, such as Louisiana, have applications and other forms available on-line, and accept these applications electronically. Some have instituted other technological conveniences, such as ACH transactions for assessment payments.

"Financial Services Regulatory Relief Act of 2002"

We would like to thank the Committee for considering our views on the "Financial Services Regulatory Relief Act of 2002."

State Member Bank Parallel Treatment

In particular, CSBS commends you for including Section 405 in the draft legislation, this provision gives the Federal Reserve more flexibility to allow state member banks to engage in investment activities authorized by their chartering state and approved by the FDIC as posing no significant risk to the deposit insurance fund.

This amendment removes a provision in the Federal Reserve Act that places unnecessary limitations on the powers of a state member bank, limiting state member banks to the activities granted to national banks. As state-chartered nonmember banks have always been allowed to exercise expanded powers – within the confines of safety and soundness – it is an appropriate regulatory relief effort to eliminate this prejudicial and unnecessary distinction between state-chartered member banks and state-chartered nonmember banks. This provision does away with this arcane restriction, which has no basis in promoting safety and soundness.

As you know, Congress has consistently reaffirmed the states' ability to craft banking charters to fit their economic needs and experiment with new products and services. Congress once again reaffirmed this authority in 1991, when FDICIA allowed states to continue to authorize powers beyond those of national banks.

An empowered state banking system is essential to the evolution of our banking system and elemental to state economic development. This change helps to advance that goal.

Interstate Branching

With respect to interstate branching requirement, as you may know, current Federal law has taken an inconsistent view toward how banks may branch across state lines. While Riegle-Neal gave the appearance that states could control how banks could enter and branch within their borders, this has not always been the reality.

Perhaps because it was believed that the Federal thrift charter would be eliminated at the time Riegle-Neal was adopted, the law was not applied to federally-chartered thrifts. The result is that a Federal thrift can branch without regard to state law and rules of entry.

Since the passage of Riegle-Neal, the Office of the Comptroller of the Currency has promulgated creative interpretations of the National Bank Act that effectively circumvent the application of Riegle-Neal to "branch-like" operations. CSBS unsuccessfully opposed these interpretations in a comment letter.

The result is that state-chartered institutions, particularly community banks wishing to branch interstate, are at a competitive disadvantage to those larger institutions that can already branch without restriction through the use of Federal options.

Because of such circumventions of state branching laws, states must try to address this disadvantage imposed on their state-chartered banks. Since the passage of Riegle-Neal a number of states have been moving toward allowing *de novo* branching. Seventeen states now allow *de novo* branching, most on a reciprocal basis. In December 2001, the CSBS Board of Directors approved policy to encourage all states to consider enacting *de novo* branching laws.

In your review of how Federal law addresses branching for all charters, please recognize that the majority of states have not passed *de novo* branching laws. Whatever the outcome, we urge Congress to eliminate the disadvantage it has created for state banks because of inconsistent application of Federal law.

Other Suggestions

We also ask the Committee and the Congress to address the implementation and implications of regulatory preemption by the Office of the Comptroller of the Currency and the Office of Thrift Supervision.

The OTS currently does not publish its preemptive decisions because of the agency's interpretation of the Home Owners' Loan Act, and because the guidelines for preemption articulated in the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 were never applied to the OTS.

The OCC has also determined that many of its decisions are interpretations of the National Bank Act, and not preemption by the OCC, thus avoiding disclosure. The banking system would benefit greatly from a more open dialogue between the federal government and the states about applicable law for federally chartered financial institutions.

State bank supervisors also believe that the OCC's interpretation of whether a state law is in "conflict" with the National Bank Act has been interpreted beyond Congressional intent. CSBS further believes that the OTS assumption that HOLA "preempts the field" of state law hangs not so much on statutory language, but rather on creative interpretations of that language and court decisions. We strongly encourage the Congress to revisit and clarify the scope of the preemptive authority it has delegated to these agencies.

We also seek clarification of the "Riegle-Neal Amendments Act of 1997" that the Congress enacted to allow state-chartered banks to operate interstate with greater certainty, while respecting their chartering states' laws. The language of those amendments may need refining to better reflect the 21st-century interstate environment in areas such as trust services and non-branch operations.

CSBS believes this request for review of preemption and applicable law is appropriately a regulatory burden reduction matter. Our banking system – particularly for state-chartered institutions – is a complex and evolving web of state and federal law. Greater sunshine on OCC and OTS interpretations of applicable law for the institutions they charter would also help clarify applicable law for our nation's over 6,000 state-chartered banks, representing nearly 70% of all insured depositories.

A clearer articulation of OCC and OTS standards of preemption would also lessen the legal burden of litigation over the federal regulators' sometimes tenuous interpretations of applicable law.

We need a banking system that both acknowledges the needs of multistate banks and financial services firms and protects consumers. Given that consumer needs can vary considerably across our nation, and that the states are closer to their citizens, we believe that consumer protection is often best addressed at the state level. CSBS is committed to working with the Congress to address the needs of an evolving nationwide financial services system in a way that respects the interests of all our nation's financial services providers and minimizes regulatory burden, while also protecting our nation's consumers.

CONCLUSION

The quest to streamline the regulatory process while preserving the safety and soundness of our nation's financial system is critical to our economic well-being and to the health of our nation's financial institutions. Like you, and like our federal agency counterparts, we at the state level are constantly balancing the public benefits of regulatory actions against their direct and indirect costs. Our most important guide is the fundamental principle of safety and soundness.

We commend this committee for its efforts in this area. State bank supervisors appreciate the Committee's interest in eliminating barriers in federal law to innovation from the state charter. We thank you for this opportunity to testify on this very important subject and look forward to any questions you and the members of the subcommittee might have.